Message Text

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FM SECSTATE WASHDC
TO AMEMBASSY NEW DELHI

LIMITED OFFICIAL USE STATE 248794

E.O. 11652:
TAGS: ENRG, IN
SUBJ: INDIA AND OIL: SUPPLY AND PRICING EFFECTS

REF: NEW DELHI 14903

1. FOLLOWING CONDENSATION OF TESTIMONY OF GEORGE M.BENNSKY, DIRECTOR, OFFICE OF FUELS AND ENERGY, THE HOUSE FOREIGN AFFAIRS COMMITTEE, NOVEMBER 29, IS FOR YOUR USE WITH GOI AS APPROPRIATE.

2. AS A RESULT OF ARAB CUTBACKS AND EMBARGOES THE WORLD'S AVAILABILITY OF OIL HAS BEEN REDUCED BY OVER 5 MILLION BARRELS PER DAY (B/D), OR ABOUT 10 PERCENT OF WORLD CONSUMPTION. THE NEXT 5 PERCENT PRODUCTION CUT COULD BRING THE WORLD-WIDE LOSS TO OVER 6 MILLION B/D, OR ABOUT 12 PERCENT OF THE NON-COMMUNIST WORLD'S WINTER DEMAND. IF THE EMBARGO AND CUTBACK CONTINUE THROUGH APRIL 1974, ARAB OUTPUT COULD BE ABOUT 10.5 MILLION B/D OR LESS THAN HALF THE EXPECTED LEVEL

3. US: DEPARTMENT ESTIMATES THAT OUR IMPORTS FROM ARAB PRODUCERS IN 1973, BOTH DIRECTLY FROM THEM IN THE FORM OF CRUDE AND INDIRECTLY AS PRODUCTS VIA THIRD COUNTRY

REFINERIES, HAVE BEEN ON THE AVERAGE AS FOLLOWS: VOLUME (IN 000 B/D):

SAUDI ARABIA - 600; ABU DHABI - 150; KUWAIT - 150;

IRAQ - 50; LIBYA - 350; ALGERIA 150; OTHER ARAB - 150;
TOTAL 1.600.

4. THUS ABOUT 25 PERCENT OF ALL AMERICAN OIL IMPORTS OR 10 PERCENT OF TOTAL U.S. OIL CONSUMPTION CAME FROM THE ARAB PRODUCERS. ABOVE FIGURES ARE OF ACTUAL PRE-EMBARGO IMPORTS AND DO NOT REFLECT LOSS OF OVER 500,000 B/D OF HEATING OIL THAT WE HAD HOPED TO IMPORT THIS WINTER FROM EUROPEAN REFINERIES TO HELP MEET SHORTAGES WHICH ALREADY THREATENED US BEFORE THE ARAB EMBARGO. THESE STATISTICS ALSO DO NOT INCLUDE UPTO 300,000 B/D IN LOSSES OF OVERSEAS SUPPLIES TO OUR MILITARY FORCES, WHICH NOW MUST BE MADE UP FROM DOMESTIC SOURCES. THERE WILL ALSO BE SOME DECREASE IN NORMAL SHIPMENTS FROM CANADA, WHICH SEEKS TO DIVERT SOME OF ITS WESTERN PRODUCTION, PERHAPS UP TO 100,000 B/D, TO ITS IMPORT-SHORT EASTERN PROVINCES.

5. THUS, TAKEN ALL TOGETHER, THE ARAB OIL BOYCOTT WILL DEPRIVE THE U.S. OF BETWEEN 2.5 AND 3 MILLION B/D OF OIL THIS WINTER OR UP TO 17 PERCENT OF OUR ESTIMATED WINTER DEMAND OF 18.5 MILLION B/D.

6. UNFORTUNATELY, POSSIBILITIES FOR COMPENSATING FOR THE EFFECTS OF THE EMBARGO AND CUTBACK FROM NON-ARAB SOURCES ARE VIRTUALLY NIL, AS THESE PRODUCERS ARE ALREADY OPERATING AT CAPACITY PRODUCTION LEVELS. WE PROBABLY CAN EXPECT TO RECEIVE THROUGH THE WINTER MONTHS TOTAL OIL IMPORTS AVERAGING ABOUT 4 MILLION B/D, AS AGAINST OUR PROJECTED REQUIRED RATE OF 7 MILLION B/D. ALMOST 70 PERCENT OF THIS REDUCED QUANTITY WOULD COME FROM LATIN AMERICA (PREDOMINATLY VENEZUELAN CRUDE) AND CANADA, WITH MOST OF THE REMAINDER ARRIVING FROM NIGERIA, IRAN, AND INDONESIA.

7. JAPAN: THE JAPANESE SUPPLY SITUATION IS NEARLY AS BAD AS OURS AT THE MOMENT. JAPAN IS WHOLLY DEPENDENT ON IMPORTED OIL AND 40 PERCENT OF IT COMES FROM ARAB SOURCES.
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WE ESTIMATE THAT, BY MID-WINTER, JAPAN'S IMPORT LOSS WILL RUN ABOUT 15 PERCENT OF ITS CONSUMPTION OF ABOUT 6.2 MILLION B/D. HOWEVER, THIS PERCENTAGE WILL GROW TO ABOUT 20 PERCENT OF CONSUMPTION IN LATE WINTER AS PROGRESSIVE MONTHLY CUTBACKS TAKE THEIR TOLL. JAPAN'S OWN SHORTFALL ESTIMATES ARE MORE PESSIMISTIC THAN OURS, RANGING BETWEEN 20 PERCENT NOW TO 30 PERCENT BY THE END OF THE WINTER. GOJ HAS EMPHASIZED THAT 70 PERCENT OF ITS ENERGY CONSUMPTION IS OIL AND THEREFORE THAT THE NEGATIVE IMPACT ON ITS INDUSTRIAL PRODUCTION AND EMPLOYMENT WILL BE MORE SEVERE THAN IN OTHER CONSUMING COUNTRIES.

8. WESTERN EUROPE: IT IS DIFFICULT TO GENERALIZE ABOUT THE IMPACT ON WESTERN EUROPE. SOME COUNTRIES, SUCH AS THE UNITED KINGDOM, FRANCE, AND SPAIN HAVE BEEN OFFICIALLY DUBBED "FRIENDLY" BY THE SAUDIS AND OTHER ARAB PRODUCERS, WHILE OTHER WEST EUROPEANS, SUCH AS WEST GERMANY AND ITALY, ARE NOT GIVEN PREFERENCE BY THE SAUDIS AND HAVE TO SHARE REMAINING AVAILABLE OIL WHICH OF COURSE MEANS IMPORT REDUCTIONS. HOWEVER, BY MID-WINTER WE EXPECT THE OVERALL WEST EUROPEAN SHORTFALL TO STAND AT 3 MILLION B/D OR 15 PERCENT OF CONSUMPTION, WHICH HAS BEEN ESTIMATED AT 19.5 MILLION B/D. TAKEN AS A WHOLE, WESTERN EUROPE RECEIVES ABOUT 73 PERCENT OF ITS OIL FROM ARAB SOURCES.

9. EVEN THOUGH THE UNITED KINGDOM AND FRANCE, AS FRIENDLY NATIONS, WILL CONTINUE TO RECEIVE ARAB OIL AT THE SAME LEVELS PREVAILING EARLIER IN 1973, THERE IS NO PROVISION FOR GROWTH IN DEMAND DURING THE WINTER MONTHS. THEREFORE FRANCE PREDICTS A 10 PERCENT SHORTFALL, WITH GREATER LOSSES IN HEATING OIL, AND THE UK ANTICIPATES CUTS OF UP TO 15 PERCENT. BOTH THE UNITED KINGDOM AND FRANCE RECEIVE 70-80 PERCENT OF THEIR OIL FROM ARAB PRODUCERS.

10. UNDER NORMAL CIRCUMSTANCES THE DUTCH, WHO ARE TOTALLY EMBARGOED, IMPORT FOR REEXPORT REFINING AND DOMESTIC USE ABOUT 2 MILLION B/D, OF WHICH 1.3 MILLION B/D OR 65 PERCENT ARE OF ARAB ORIGIN. DUTCH DOMESTIC CONSUMPTION IS ABOUT 700,000 B/D, 75 PERCENT OF WHICH USUALLY COMES FROM NON-ARAB SOURCES. THEREFORE ABOUT 25 PERCENT OF DUTCH DOMESTIC DEMAND WILL BE LOST THIS

WINTER AND THE COUNTRY'S SUBSTANTIAL REEXPORT TRADE WILL ALSO BE GREATLY REDUCED.

11. WEST GERMANY, EUROPE'S LARGEST OIL CONSUMER, WILL ALSO BEAR THE BRUNT OF PRODUCTION CUTBACKS. GERMANY IMPORTS ABOUT 3.2 MILLION B/D, OF WHICH 70 PERCENT CAME FROM ARAB PRODUCERS. A FURTHER COMPLICATION IS THAT 20 PERCENT OF GERMANY'S CRUDE OIL AND A SIGNIFICANT AMOUNT OF ITS PRODUCTS ARE IMPORTED VIA OR REFINED IN ROTTERDAM. THERE REMAIN UNCERTAINTIES AS TO WHAT EXTENT THE EMBARGO OF THE NETHERLAND'S ROTTERDAM FACILITIES WILL AFFECT GERMANY'S IMPORTS. HOWEVER, FRG FIGURES THAT ITS LOSSES WILL BE 15-20 PERCENT OF CONSUMPTION DURING THE WINTER.

12. PRICE ISSUE: THE CURRENT POLITICALLY IMPOSED CUTBACKS IN OIL SUPPLIES HAVE SUBSTANTIALLY WORSENED THE ALREADY TIGHT SELLER'S MARKET, AND WE FIND LONG LINES OF BUYERS WILLING TO PAY EVER HIGHER PRICES FOR THE LIMITED AMOUNTS OF CRUDE AVAILABLE FOR DIRECT SALE BY

PRODUCER GOVERNMENTS. FOR EXAMPLE, CURRENT BIDDING FOR A RELATIVELY SMALL QUANTITY OF NIGERIA'S SOUGHT AFTER LOW-SULPHUR CRUDE HAS PUSHED OFFERING PRICES UP TO OVER $16 A BARREL. ASSUMING THIS IS AN F.O.B. PRICE, IT COMPARES WITH $3.65 FOR A REPRESENTATIVE MORE SULPHUROUS PERSIAN GULF CRUDE.

13. THE COMPANIES HAVE RECENTLY SOUGHT TO CONVINCE OPEC OIL MINISTERS THAT THE CURRENT IMBALANCE OF INTERNATIONAL OIL SUPPLY AND DEMAND MAKES RELIANCE ON MARKET PRICES, ESPECIALLY SPOT SALES OF LIMITED AMOUNTS, TOO DAMAGING TO CONSUMING COUNTRIES. THEREFORE, THE COMPANIES PROPOSED NEGOTIATION OF A MORE RATIONAL PRICING SYSTEM THAT WOULD BALANCE OUT THE PRODUCERS' GENERAL INFLATION CONCERNS WITH THE FINANCIAL CONCERNS OF THE CONSUMERS OF THEIR OIL. THE OPEC OIL MINISTERS CONTINUE TO TAKE THE POSITION THAT FURTHER CRUDE PRICE INCREASES ARE JUSTIFIABLE CONSIDERING THE RAPID RISE IN PRICES OF COMMODITIES THEY IMPORT FROM THE CONSUMING COUNTRIES AND THE HIGH TAXES IMPOSED BY THE CONSUMER GOVERNMENTS ON PETROLEUM PRODUCTS, ESPECIALLY GASOLINE. THESE MINISTERS HAVE INDICATED THAT NEW

POSTED PRICES WOULD BE ESTABLISHED BY JANUARY 1, IF NOT BEFORE.

14. THE EFFECTS ON THE U.S. AND OTHER MAJOR CONSUMERS OF THE OCTOBER PRICE INCREASE ALONE IS SUBSTANTIAL. ALTHOUGH OUR FIGURES ARE NOT YET COMPLETE, PRELIMINARY ANALYSIS INDICATES THAT OUR 1974 OIL IMPORT BILL COULD REACH $12 BILLION, OF WHICH ALMOST $3 BILLION WOULD BE CAUSED BY THE OCTOBER PRICE RISES. THIS ASSUMES OF COURSE THAT THE ARABS ARE EXPORTING OIL TO US AGAIN IN 1974. BY COMPARISON OUR 1972 OIL IMPORTS RAN $7 BILLION AND THIS YEAR WE ARE EXPECTING TO IMPORT ABOUT $9 BILLION WORTH OF OIL. THE COST TO THE JAPANESE IS ESTIMATED AT ABOUT $3 BILLION AND TO WESTERN EUROPE AT ABOUT $8 BILLION. THE IMPACT OF STEEP RISES IN OIL PRICES SINCE 1971 ON THE LDCS ARE VERY SUBSTANTIAL AND VERY NEGATIVE IN TERMS OF THEIR DEVELOPMENT. THE EMBASSY'S 14122 GIVES AN EXAMPLE OF THE HEAVY B/P COSTS THAT STEEP OIL PRICE RISES IMPLY FOR LDCS. WE ARE BEGINNING TO SEE AN INCREASED AWARENESS OF THE SERIOUSNESS OF THE PRICE PROBLEM IN OUR REPORTS FROM A NUMBER OF OUR POSTS IN LDC NATIONS INCLUDING SOME OF THOSE IN CENTRAL AMERICA AND SOUTHEAST ASIA. THESE TRADE FIGURES WILL BE BALANCED OUT IN VARYING DEGREES IN THE DIFFERENT INDUSTRIAL CONSUMING COUNTRIES DEPENDING ON EXPORT INCREASES AND CAPITAL FLOWS GENERATED BY INCREASED INCOMES. RUSH

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